THE FOREIGN TRADE BALANCE OF THE UNITED STATES SINCE THE ARMISTICE

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I. Our International Position at the Close of the War

I believe that our problems in foreign trade cannot be satisfactorily analyzed by reference merely to our current situation. I hope I shall be pardoned, therefore, for recalling at the outset some familiar facts of our earlier experience. From the crisis of 1873 to the outbreak of the war our balance of trade had been moderately favorable, the excess of exports representing in the early years chiefly the growing interest payments on foreign capital previously invested in our railroads and other enterprises. Beginning in the late nineties our trade balance showed a marked and sustained increase, representing in addition to interest payments the notable growth in the expenditures of our tourists abroad and in the remittances of our rapidly growing immigrant population. Down to the war, however, our favorable balance had been of modest proportions, averaging about $487,000,000 a year in the period 1896-1914, and representing, as nearly as can be stated, net interest payments of about $160,000,000, tourists' expenditures of $150,000,000, immigrants' remittances of about $150,000,000, and a number of minor debit items, of which payment for ocean carriage was the chief.

Then came the World War, bringing a series of changes which, though in many respects clearly foreshadowed in the two decades preceding the war, came so rapidly and spectacularly and on so gigantic a scale as to make foreign trade one of our major economic problems. The main features of our war-time balance of trade can be briefly sketched. Exports in four and a half years totalled $22,974,000,000 and imports $11,166,000,000. Our excess of exports, owing to war-time needs for our products at rapidly rising prices, coupled with Europe's inability to export as before, reached the huge total of $11,808,000,000. This balance was financed mainly by the export of American capital, in the form of public and private loans to foreign countries and of American securities returned to this side in connection with the operations of exchange stabilization. Other items were of course present, notably the large net inflow of gold, which amounted to $1,029,000,000, but all of these items were of minor importance compared with the movement of capital and of goods. The total net export of capital, as nearly as it can be stated, was distributed as follows:

Securities returned from Europe	$2,000,000,000
Private foreign bond issues	1,520,100,000
Advances by the United States government under credits established in favor of allied governments..........	7,319,500,000
Total	$10,839,600,000[1]

As this huge outgo of American capital continued it was seen that the eventual outcome must be the conversion of the United States from the debtor to the creditor position in international trade. Indeed, before the war had ended, it was being assumed in many quarters that this fundamental change had already occurred; and that what in other countries had come only very gradually, as the result of slowly accumulating foreign investments, combined perhaps, as in the case of Great Britain, with a steadily growing merchant marine and other sources of income from abroad, had taken place in the United States under the pressure of an unprecedented war in about four years time. Since our prewar debit balance had been paid by an excess of exports, the logical implication was that the new net credit balance would induce an excess of imports; that there would very shortly be an overturn of our trade balance comparable with that of 1873.

The study undertaken by the *Review of Economic Statistics* in the spring of 1919,[2] however, indicated, I believe, that at the close of the war period our new creditor position had not yet been clearly achieved. An important change had taken place in our capital and interest account. A net outward payment of about $160,000,000 a year had been supplanted by a net inward payment of about $525,000,000, provided that Europe were able to assume at once so heavy a charge. Even assuming full payment of interest, however, it was still doubtful whether at that time our balance would show a net sum receivable. The item of freight payments, by reason of our merchant marine expansion, had apparently passed out of our debit column, but was still too small to exert much effect on the balance. Much more important were immigrants' remittances and tourists' expenditures. Even if taken at a moderate prewar estimate, about $300,000,000 a year when combined, they reduced our new credit balance to about $200,000,000.[3] And it was generally conceded that immigrants' remittances had greatly increased, and that tourists' expenditures, which had virtually ceased during the war, might be expected to revive strongly after a time.

More important than these, however, were the further changes likely to occur in our international capital and interest account. Could

[1] The *Review of Economic Statistics,* July, 1919, p. 305.

[2] C. J. Bullock, J. H. Williams, and R. S. Tucker, "The Balance of Trade of the United States," July, 1919.

[3] The *Review of Economic Statistics,* July, 1919, p. 253.

Europe soon assume her interest obligations? Even assuming that she could, was it not likely that for some years the net movement of capital would be from the United States, rather than toward it? A moderate outflow of foreign investment would still suffice, when added to the other items mentioned, to offset the annual inflow on interest account, and thus to postpone the overturn of the trade balance. Eventually, the growing interest charge would become so large as to exceed the sum of new annual investments, tourists' expenditures, and immigrants' remittances; but that result would show itself only after some years. On the basis of the data then available it was concluded that, although it was not possible to predict with safety whether the overturn of our trade balance would come after two years or not for a decade, it was certain that in view of Europe's continued extreme need of our products and our loans, our excess of exports could not be expected to disappear so rapidly as had been generally assumed.

II. Our Balance of Trade Since the Armistice

In the two years that have passed since the armistice that conclusion has been justified. The transition from war conditions has been very gradual. Except for Great Britain, Europe's recovery has been slow, though in the past year there have been a number of hopeful signs. Except in Great Britain, budgetary deficits are still the rule; taxation runs behind current expenditure. The German indemnity remains unsettled. The basis of international trade with Europe is still inconvertible paper; paper issues have continued to be multiplied; the ratio of gold holdings to bank liabilities has grown smaller; and the gold embargoes, though relaxed by Great Britain, have elsewhere been consistently maintained. The foreign exchanges, following the unpegging of sterling in March, 1919, and the discontinuance of the credit advances by our government in June, 1919, declined rapidly, reaching their low mark in February, 1920. The recovery which followed was only moderate, and this past fall a downward movement again set in. The dollar, which in war time had been at a discount in many neutral countries, though at a premium in the warring countries, has gone to a premium virtually throughout the world. With the removal of our embargo on gold in June, 1919, gold has been moving to settle our adverse balances with the neutral countries, but has not moved from the belligerent countries to us on a comparable scale, so that we have witnessed the seeming paradox of a nation with the largest favorable trade balance that has ever existed in any country experiencing at the same time a heavy net outflow of gold, the net export to November 1, 1920, being $260,000,000.

Of chief importance as regards their effect on our balance since the armistice have been the changes in our international capital and interest account. The payments of interest on the huge sum of government credit advances have been suspended. The cash advances (less repayments) under these credits now (November 15, 1920) amount to $9,466,283,170. Last April announcement was made that interest payments on the government credits would be payable in funding bonds for three years; and that the funding plan would extend to back interest and also to the obligations of foreign governments for purchases of our war supplies. These obligations at the close of the fiscal year 1920 amounted to $563,032,739.63. Adding back interest, then, which now amounts to about $800,000,000,[4] we have a present total of about $10,814,000,000 of government credit items, on which the annual interest payments at 5 per cent would be $541,000,000.

An analysis of our balance of payments for the calendar year 1919[5] indicated what would be the effect of the funding of these interest payments. Excluding new capital loans and repayments, it was shown that so long as these government interest items remained unpaid in cash or its equivalent, our balance on invisible items would still show a net debit, the annual payments for immigrants' remittances and tourists' expenditures exceeding the annual receipts of interest payments on private capital invested abroad and freight payments for the services of our expanded merchant marine by some $200,000,000 a year. And it is worth noting that in this computation tourists' expenditures were taken at only $50,000,000 a year, whereas the lowest authoritative estimates of this item in the prewar period put it at not less than $150,000,000 a year.

It is apparent, therefore, that so long as the interest on government credits remains unpaid, except in funding bonds, there is every likelihood that we shall continue to have a net balance of indebtedness, and a continuation of our excess of exports, though of reduced amount compared with the huge balances of recent years. As to how long this suspension of interest payments will continue thus to affect our trade balance, no definite answer can yet be given. Secretary Houston's latest announcement is that the funding arrangement has not yet been settled but is still in the stage of discussion; and that the Treasury's proposal is to fund the interest merely for two or three years from the spring of 1919, when interest payments ceased. If this is done, it will mean that our excess of exports, so far as due to the suspension of interest payments, would continue until the spring of 1921 or 1922, ac-

[4] To January 1, 1920, $324,212,000 (see Frank A. Vanderlip and John H. Williams, "The Future of our Foreign Trade," p. 36); for the year 1920 about $473,000,000.

[5] "The Future of Our Foreign Trade," p. 37.

cording to the period to be covered by the funding plan. Whether the interest payments will in fact be resumed so soon as here indicated must depend, of course, upon the rapidity of Europe's recovery from the effects of the war. It would seem certain, however, that Great Britain could resume at that time, and it is therefore worthy of note that of the total government credits to finance exports Great Britain still has $4,196,818,538.44 (December 1, 1920), or 44 per cent of the whole.

It is not predicted, however, that our excess of exports will necessarily disappear *immediately* upon the resumption of these interest payments, or that our balance of trade will be dominated forthwith by the separate effect of this single factor. Much will depend, of course, upon the extent and rapidity of Europe's recovery. She may continue for a time still to need our goods beyond her capacity to pay with goods, gold, or securities, and to shift the burden of payment for the excess upon our bankers and exporters. A resumption of these huge interest payments, however, would be the best evidence yet apparent of a substantial recovery in Europe.

A factor of at least equal importance with the question of interest payments during the immediate future will be that of new foreign investments of American capital abroad. Whether this stream of foreign investment is to occur, on a scale sufficient to offset the annual interest payments on our capital, public and private, already so invested, and also to offset maturing bond issues and repayments of capital on government credits, is today the question of supreme importance. Its significance is many sided. It has a bearing not only upon the question of fact here raised—as to whether, and when, our balance of trade is to be overturned—but also upon the condition of our exporters and their bankers, now burdened with short-time credits extended to foreign buyers of our products; upon the character, extent, and direction of our foreign trade, in both exports and imports; and upon the future importance of the United States as an international money market.

To understand adequately the importance of the consequences now hinging upon foreign investment of American capital, it is necessary to examine in some detail the state of our trade balance since the armistice and the means whereby it has been financed. From November 1, 1918, to November 1, 1920, our exports exceeded our imports by $6,782,000,000, or by about a billion dollars more than during the last two years of the war. Both exports and imports have shown a large increase in the value figures. Exports for the two years to November 1, 1920, were $15,841,000,000, or over three billion dollars larger than in the last two years of the war; and imports amounted to $9,059,000,000, which is only 17 per cent less than the combined imports of the

entire war period. Total value of exports has so far shown no tendency to diminish. In 1919 it was 29 per cent greater than in 1918, and in the first ten months of 1920 it was 5 per cent greater than in the same period of 1919. Imports in 1919 were 22 per cent more than in 1918, and in the first ten months of 1920 they were 52 per cent greater than in the corresponding months of 1919. Until the recent harvest season, therefore, when exports experienced the usual seasonal expansion and imports fell off by reason of falling prices in the raw material markets and the industrial depression attendant upon our own falling price level, imports were increasing much faster than exports and were rapidly filling up the gap between the two. Yet for the whole period, so marked had been the expansion of exports in 1919, exports exceeded imports by a greater figure than in any equal period of our history.

It is important to remember that this remarkable expansion of our foreign trade since the armistice has been much more in the value figures than in the quantity figures. Mr. W. A. Berridge, in the *Review of Economic Statistics* for October, 1919, showed that in the fiscal year 1919 physical volume of exports was only 40 per cent in excess of the 1911-14 average, whereas export prices had advanced 127 per cent and the total value of exports 317 per cent. Compared with the 1915-18 average, physical volume of exports in the fiscal year 1919 showed an actual decline of 2.8 per cent, whereas export prices advanced 52 per cent and total value of exports 48 per cent. Since 1915 (and until the present price recession) export prices have been consistently higher than domestic prices, the excess reaching more than 10 per cent in the fiscal year 1919. The foreign trade index of the *Federal Reserve Bulletin* for November, 1920, shows that with price changes eliminated the monthly average value of exports in the calendar year 1919 (which on this basis is an index of physical volume of exports) was only 18.6 per cent greater than that for 1913; and that in the first nine months of 1920 the monthly average was only 3.2 per cent higher than in 1913. Quantity of exports has thus declined 14 per cent since 1919, and this year has been but little more than before the war. Quantity of imports shows a striking contrast. The monthly average quantity imported in 1919 was 71.7 per cent greater than that of 1913; and the monthly average for the first nine months of 1920 was 92.2 per cent greater than that of 1913.[6]

[6] It must be admitted that the indices of the *Federal Reserve Bulletin* are not so comprehensive as could be wished. They include 29 leading exports which in 1913 formed 56.3 per cent of the total export values, and 25 leading imports which in 1913 were 47.7 per cent of the total import values. Yet the commodities included are representative, and the proportions of the whole which they form are considerable.

Here is striking refutation of the contention of those who hold that our foreign trade since the armistice has represented the supplying of foreign markets with our products at the expense of the home market; that our large export balances have drained our markets of goods, induced the holding back of goods, intensified speculation, and have thereby raised our prices at home. It is clear that, on the contrary, our foreign trade since the armistice has increased the proportion of the world's production being supplied to the domestic market.

This statement of quantity of trade does not, of course, alter the fact that our export balance since the armistice has been unsoundly financed, and that the resultant expansion of bank credit has probably been one important factor in the continued rise of prices which reached its peak in May, 1920. To the extent that this is the case, it would appear to support the quantity theory of money; and it is, therefore, interesting to note the paradoxical fact that among the economists who in recent months have been most prominent in calling our attention to the expansion of bank credit occasioned by our recent methods of financing foreign trade, has been one of the most vigorous credits of the quantity theory.

III. Our Trade Balance Has Been Financed by Bankers' Credits

As has been said, however, the value figures of trade since the armistice show an excess of exports amounting (to November 1, 1920) to $6,782,000,000, the largest in our history. Here is striking proof of Europe's continued inability to buy goods with goods. Since the middle of 1919 this condition has given rise to a new and very serious problem. In June, 1919, the government withdrew from the field of export financing.[7] Since that time the burden of supplying Europe with our exports has fallen chiefly upon our bankers and exporters, in the form of short-time extensions of credit.

The part played by long-time investment since the armistice has been small in comparison. Since the beginning of 1919, new foreign bond issues have been fully offset by maturing issues, the total figures to November 1, 1920, being $897,000,000 of new issues (government, municipal, and corporate) against $1,086,000,000 of foreign loans matured.[8] Foreign bond issues have not, however, represented the total outgo of American capital during the period. They do not include extensions of old plants abroad and establishment of new ones by American corporations, the purchase by American concerns of lands, mines,

[7] The government credit advances virtually ceased at that time, though some small advances of cash under credits previously granted have since been made. Also, the War Finance Corporation was continued down to the spring of 1920. But credit advances by the latter were small.

[8] The detailed figures, furnished by J. P. Morgan & Co., not here reproduced.

and factories in Canada, docks in Hamburg, sugar mills and plantations in Cuba, new oil fields in Venezuela and Colombia, or new packing plants in Brazil. All observers agree that investments of this sort have been considerable, particularly in the case of Canada. The total of these investments in 1919 was estimated to be not less than $300,000,000, and for the whole period down to November 1, 1920, half a billion dollars would be a conservative figure. Including these investments and also American purchases of European internal securities and the return of American securities from Europe (figures for which are given in the accompanying balance sheet), our total foreign investment since the beginning of 1919 has been about $1,649,000,000, or about $563,000,000 in excess of loans matured and paid off.[9]

That balance has been financed, as we have said, by bankers' credits. The estimates that have been made of these short-time credits have shown wide variation, and for the most part, I believe, have been exaggerated. In February and March, 1920, while investigating our balance for 1919, I received estimates ranging from $500,000,000, to $5,000,000,000. My own computation for 1919 showed short-time credits of $1,307,000,000.[10] Much larger it could not have been, for the phenomenal export balance of the first half of the year ($2,448,000,000) was fully covered by the government credit advances, which amounted (inclusive of all relevant items) to $2,665,000,000,[11] virtually the whole

9 Moreover, some authorities have raised the question whether these matured bond issues have in fact been fully paid off in every case. The most important item was the Anglo-French loan, which fell due October 15, 1920. The French half was met in part by a new loan of $100,000,000, leaving $400,000,000 payable. The *Federal Reserve Bulletin* for November (p. 1129) questions whether this sum was paid off by the accumulation of dollar balances through purchase of exchange, or was met by the sale of foreign securities in this market. It states that when analyzed the operation appears "to have amounted largely to a mere shifting of credits," the French and British governments paying off the loan with foreign-held American securities. The importance of this statement does not need explaining. To the extent that maturing loans have been paid off with funds realized in this manner, they represent not an offset to new foreign bond issues in this market but an addition to them. To take only the Anglo-French loan (*i.e.*, $400,000,000, excluding the $100,000,000 new French loan), it would mean that new foreign investments in the past two years have contributed to the financing of the trade balance not half a billion, as we have stated, but about $1,400,000,000. In other words, the current estimates of bankers' credits to finance exports would be reduced by $800,000,000. In the absence of detailed data on transactions of this sort, however, we must continue to count maturing bond issues as European payments in our balance sheet. On this basis, the net foreign investments of American capital since the armistice have been comparatively small, entirely inadequate to finance our one-sided balance of trade.

10 "The Future of Our Foreign Trade," p. 32.

11 See "The Future of Our Foreign Trade," *The Review of Economic Statistics*, April, 1920, p. 32. The same figures are given in the *Chase Economic Bulletin*, October 5, 1920, p. 29.

of which was advanced in the first half of the year. The trade balance of the second half of the year was but $1,568,000,000. In 1920, Europe's unfunded debt to us has undoubtedly increased markedly; and of late months the total since the armistice has been most frequently estimated at from three to four billion dollars. I shall not attempt to read the details of the accompanying balance sheet. It shows that between January 1, 1919, and November 1, 1920, the United States piled up a surplus of credits not otherwise accounted for of $2,852,000,000. This figure of $2,852,000,000 is put forth merely as preliminary, subject to revision in my analysis of the balance of payments for the calendar year 1920, which will appear in a forthcoming issue of *The Review of Economic Statistics.* It is not improbable that further investigation will show that floating credits outstanding on November 1, 1920, were somewhat less than the figure indicated by the table, and probably did not exceed $2,500,000,000.

THE BALANCE OF INTERNATIONAL PAYMENTS OF THE UNITED STATES, JANUARY 1, 1919, TO NOVEMBER 1, 1920[12]
(Units of $1,000,000)

		Credit	*Debit*
1.	Exports of Merchandise and Silver	$15,098	
2.	Exports of Gold	653	
3.	Foreign Loans matured and paid off	1,086	
4.	Freight Payments payable to United States and Sale of Ships	1,011	
5.	Interest Payments on Government Credits to Allied Governments	177	
6.	Interest Payments on Private American Capital Abroad	311	
1.	Imports of Merchandise and Silver		8,765
2.	Imports of Gold		393
3.	Gold held by Bank of England for Federal Reserve Banks		none
4.	New issues of Foreign Government, Provincial and Municipal Loans		771
5.	Foreign Corporate Bond Issues		126
6.	American Securities Returned		200
7.	American Purchases of European Internal Securities		155
8.	Other Foreign Private Investment		500
9.	Net sum of U. S. Government Cash Advances under Credits Established in Favor of Foreign Governments		2,131
10.	U. S. Government Purchases of European Currencies to Cover Expenditures in Europe		559
11.	Relief		84
12.	Interest Payments on Foreign Capital in the United States		100
13.	Freight Payments Payable on Imports Carried in Foreign Vessels		890
14.	Credits Granted by U. S. Grain Corporation		60
15.	Immigrants' Remittances		600
16.	Tourists' Expenditures		150
	TOTALS	$18,336	$15,484
		15,484	
	NET CREDIT BALANCE	$ 2,852	

12 For sources of data and methods of computation, see *The Review of Economic Statistics,* July, 1919 and April, 1920.

The estimate of short-time credits here given differs considerably from that of Dr. B. M. Anderson, Jr., in the Chase Bank Bulletin of last October. Dr. Anderson finds the total of European unfunded indebtedness to us on September 15, 1920, to be $3,500,000,000. Allowing for our increased export balances since that date, his total on November 1 would be not less than $4,000,000,000, or over a billion dollars more than that here stated. This difference is due mainly to the fact that my balance is based upon our relations with the world as a whole, whereas Dr. Anderson's is based solely upon our relations with Europe, his view being that war conditions and the poverty of the warring nations have forced them to pile up an unfunded debt not merely in the United States but throughout the world, and that therefore they have no credits elsewhere in the world with which to offset their debits to us. From this he concludes that in seeking to find our balance of floating credits it is not permissible to subtract from Europe's debt to us our own debit balances with non-European countries.

This conclusion is, I believe, erroneous. Before considering it directly, it is interesting to note that if in strict conformity with Dr. Anderson's view that for war-impoverished nations there are no triangular offsets in international trade, we should remove from his balance sheet the trade balances of the European nations not engaged in the war, his figure would be reduced to $2,782,000,000, or by about a billion dollars. Our large exports to Europe since the armistice have been greatly swollen by the purchases of the European neutrals; with the belligerents our excess of exports has been smaller than in the war period, and has steadily diminished.[13]

The interesting question suggested by Dr. Anderson's article, however, is that of our relations with the European belligerents. It is easy to paint too black a picture. As was predicted in the earlier studies referred to at the beginning of this article, European recovery

[13] *E.g.*, Our huge trade balance in 1919, the largest in our history and $900,000,000 larger than in 1918, was due to an increase in our excess of exports to Europe, and Dr. Anderson's large figure is largely ascribable to that fact. But our balance with our former allies was almost exactly the same as in 1918. (Excess of exports to Great Britain, France, Belgium, and Italy: in 1918 $3,406,000,000; in 1919, $3,493,000,000; in 1920 (nine months), $1,837,000,000.) The increase of our European balance was caused mainly by a remarkable expansion of exports to six neutrals—Denmark, Norway, Sweden, Spain, Switzerland, and Netherlands. Our exports to them increased five-fold over 1918, and the excess of exports increased $568,000,000. From January 1, 1919, to October 1, 1920, our excess of exports to these countries was $990,000,000. These heavy exports represented in part the payment of our previous adverse balances, in part the superior buying power of nations not so much affected by the war as the belligerents, and in part, perhaps, purchases for the account of neighboring nations, as Germany, where exchange on New York has been less favorable.

has been very slow indeed.[14] But that should not blind us to the fact that in 1920 the statistics of European foreign trade have shown a distinct improvement. Space forbids a detailed statement of the figures, but in the past year the export trade of France, Belgium, and Italy has increased much faster than their imports; and German exports have exceeded imports.[15] In addition Germany has paid some twenty billion gold marks in kind to the Allies; and the other nations

[14] It is unnecessary to summarize again the darker aspects of the European situation. See previous page. As to the failure to provide adequate revenue to cover current expenditure, to which reference is there made, it should be said that the experience of all nations that have endured a régime of inconvertible paper provides evidence that depreciating paper money by its very nature, once the movement is well under way, involves almost inevitably a series of budgetary deficits—a situation in which current expenditure outruns current revenue, no matter how frequently it is attempted to raise the latter to the current level of values. For taxation is by its nature relatively fixed, whereas with paper money steadily depreciating expenditures will be rising almost from day to day. To some extent Europe's budgetary difficulties have turned on this principle. With lower prices, once the initial depression induced thereby is past, the problem will become less difficult to handle.

[15] For recent statistics of European trade see Federal Reserve Bulletins, section on Wholesale Prices Abroad; reports of International Financial Congress, Brussels, September, 1920; Industrial Research Section of Belgian Ministry of Economic Affairs, etc. The improvement shown by the foreign official statistics is confirmed by the report recently published by the United States Department of Commerce, based on a circular inquiry to American consuls in Europe: see *New York Times,* December 26, 1920.

The recovery of French trade is especially worthy of note. Exports have increased markedly in both quantity and value. In 1913 the excess of exports, representing interest payments on French capital abroad, tourists' expenditures and the like, was 18 per cent of the imports and 10 per cent of the total trade. In 1919 the excess of imports over exports was 71 per cent of the imports, or 41 per cent of the total trade. In the first nine months of 1920 the excess of imports fell to 41 per cent of the imports, and 26 per cent of total trade. The improvement has been progressive, and by August and September, the latest months for which data are available, the excess of imports had fallen below the prewar figure; being but 16 per cent of total imports or 9 per cent of total trade. Average monthly exports in 1920 increased 815,000,000 francs, or 112 per cent over 1919 (first nine months), while monthly imports have increased but 150,000,000 francs, or 6 per cent. The monthly averages for August and September are indeed remarkable. Compared with the 1919 average, they show an increase of 1,550,000,000 francs in exports, or 214 per cent, while imports have increased only 232,000,000 francs, or 9 per cent. Virtually the whole increase in imports has been in raw materials, while the expansion in exports has been mainly in manufactures.

Foreign Trade of France (1,000,000 francs)

Monthly average	Imports	Exports	Excess of Imports
1913	702	573	129
1919	2482	726	1755
1920 (nine months)	2632	1541	1091
1920 (Aug. & Sept.)	2714	2276	438

See *Federal Reserve Bulletin,* November, 1920, p. 1205.

named have made notable progress in building up the invaded territories. At the same time, our exports to Europe in 1920 (first nine months) fell $560,000,000, and our own imports therefrom increased $538,000,000, so that we have had the smallest balance with Europe since 1916 ($2,306,000,000). In other words, European foreign trade this past year would seem to have displayed a distinctly wholesome and hopeful trend.

The crux of the difference between Dr. Anderson's view and my own, however, is to be found in the analysis of the British trade revival since the armistice.[16] There can be no doubt that taking into account the remarkable revival of British exports, and also British foreign invest-

[16] Great Britain is the only European belligerent which has relaxed its gold embargo. Of our total import of gold since January 1, 1919 (to November 10, 1920) amounting to $410,000,000, $209,000,000, or over one-half, has come directly from Great Britain (and probably $40,219,000 more gold imports from Hongkong have been on British account). Approximately $131,000,000 of this represents receipts from the Reichsbank for foodstuffs sold by the United States to the German government, and a great part of the remainder has represented merely an exchange operation, the result of our ability to outbid others in the London auction rooms owing to the greater depreciation of sterling here than elsewhere, particularly since last winter; so that the actual outflow from the Bank of England has after all been small. Yet such an outflow has occurred and is one of the most significant indications yet apparent that the British trade situation is steadily returning to normal. Equally convincing have been the trade figures of the past year. Distinct improvement was noticeable in 1919; but during 1920 (first ten months), while imports have increased £331,000,000, or 25 per cent, this has been more than offset by a remarkable increase of exports, amounting to £578,000,000, or 78 per cent more than in 1919. Part of this remarkable increase in exports has of course been the result of the high prices of the first half of the year, but the same is true of the imports. Exports have, moreover, shown a notable increase in quantity, also. Excluding coal and coke, the exports increased no less than 46 per cent over the 1919 period, and including coal and coke (which have declined markedly this year) the increase has been 33 per cent. It is interesting to recall that in the same period our own quantity exports *decreased* 14 per cent. Great Britain also has normally a large excess of imports, representing interest on her foreign investments (estimated by Sir George Paish to have been about $18,500,000,000 in 1913) and the earnings of her merchant marine. Subtracting reëxports from both sides of the balance, the excess of imports in 1911-13 averaged £134,000,000, which was 22 per cent of the yearly average imports, and 12 per cent of the average total trade. In 1919 the excess of imports was £669,000,000, which was 46 per cent of total imports, and 31 per cent of total trade. In the first nine months of 1920, the excess of imports was £314,000,000, which was 24 per cent of the total imports and 12 per cent of the total trade. Taking the figures for the last four months available (July through October) the excess of imports has actually fallen below the prewar proportions, being only 13 per cent of total imports and 7 per cent of total trade. Here is proof that British trade, though still falling short of the prewar volume figures in both exports and imports, has regained the normal relation of exports to imports, and indeed even surpassed it in recent months.

ments (still estimated by Edgar Crammond at $15,000,000,000) and her shipping earnings, Great Britain on the balance of long and short-time indebtedness is still the world's creditor. As Dr. Anderson has pointed out, however, and as was stated in my own article of last spring,[17] England has used her improved position in foreign trade to assume a considerable share of the indebtedness of the Continent to us, rather than to pay off her own indebtedness here. This is indicated by the fact that New York banks and dealers have sold to London in large part their holdings of francs, marks, and other currencies; and for this reason sterling has probably ruled somewhat lower than its own merits would warrant and the other European exchanges somewhat higher.[18]

But to conclude the analysis of these sterling operations at this point is, I believe, to overlook their most significant aspect. These operations represent not a new element in our international relations, but the revival of a very old one. They indicate that in spite of the war Great Britain has already recovered her traditional position as the world's money market; and Britain's recovery of her traditional function in international trade is the very best evidence that triangular offsets are today operating upon our *own* international balance. The fact that London is assuming the burden of other countries, the fact that New York bankers are converting their holdings of other exchanges into sterling credits, the fact that we have had, meanwhile, an adverse balance with non-European countries and a favorable balance with Europe—all this is strikingly reminiscent of prewar conditions and prewar practice. Then, as now, we had an adverse trade balance with non-European countries, while we had an excess of exports to Europe. These *individual* balances had no significance, however, for then, as now, we converted our exports, no matter to what country sent, into sterling, and with London credits paid off our adverse balances to other parts of the world.

The natural assumption is that we are today continuing this practice, that we are to a large extent cancelling our debit balances with

17 "The Future of Our Foreign Trade," *Review of Economic Statistics*, April, 1920, p. 41.

18 One may easily exaggerate, however, the effects of the British assumption of other countries' burdens upon the rate of sterling exchange in this market. Our direct trade relations with Great Britain have been markedly one-sided, and have constituted the major portion of our huge balance of trade in the last six years. In the last two years of the war our trade balance with Great Britain alone showed an excess of exports amounting to $3,641,000,000, or 51 per cent of our excess of exports with the world as a whole, and since January 1, 1919, our excess ot exports to Great Britain has been $2,937,000,000, which is also 51 per cent of our total balance of trade.

non-European countries by means of London credits. If this is not the case, one is faced with the necessity of explaining how these debit balances have been disposed of. Are we to assume that non-European countries are today carrying the United States with short-time credits, as we have been carrying Europe? The fact that since the armistice the dollar has gone to a premium throughout the world would certainly not bear out such an assumption.

It is probable that the practice of converting other currencies into sterling has been intensified since the outbreak of the war by the abnormal dislocations and disparities in exchange rates occasioned by the war, which have greatly increased the scope and volume of arbitrage transactions.[19] In large part these dealings have turned upon the fact that sterling has stood higher in New York than most other currencies. The records of the Division of Foreign Exchange of the Federal Reserve Board are illuminating in this regard. They show that countries in which sterling was depreciated sold their sterling balances for dollars to New York, where sterling during the period of the pegging operations was at only 2 per cent discount, and with the dollar proceeds either bought gold for export or converted dollars into their national currencies. After our gold embargo went into effect these sales of sterling to New York diminished somewhat, the inability to purchase gold for export reducing the profitableness of the arbitrage, but even under these circumstances the volume of sterling sales in New York by foreign countries was very considerable, and was an important factor in the depression of the dollar in certain neutral countries. After the lifting of the embargo in June, 1919, it is probable that these sales of sterling by neutral countries increased, and constituted an important factor in the marked fall of the sterling rate which set in at that time, as well as in the heavy outflow of our gold during the last half of 1919.

On the other hand, countries whose exchanges were depreciated here more than the sterling rate would find a profit in buying sterling bills in this market and in effecting their payments through the sterling medium. The records of the Division of Foreign Exchange referred to indicate that such countries bought more sterling from New York

[19] On the arbitrage transactions, see Annual Report of the Federal Reserve Board, 1918, pp. 51-56; 1919, pp. 47-48. Before the beginning of the war arbitrage operations were practically confined to the three principal commercial countries of Europe. Since the war American dealers have had arbitrage operations with practically every commercial country in the world. The total arbitrage transactions of American dealers from February 20, 1918, to June 25, 1919, were:

Foreign Exchanges purchased from other countries by the U. S. $1,606,710,000
Foreign Exchanges sold to other countries by the U. S............ 1,296,454,000;
of this total of $2,903,164,000, $1,831,357,000, or 63 per cent was in sterling bills. *Ibid.*, 1919, p. 48.

than they sold to it. Though these records do not extend beyond June 25, 1919, when the operations of the Division ceased, there is no apparent reason why this practice should not have continued. Among the countries indicated by the records as making net purchases of sterling in New York are France and Italy. It is interesting to note the paradoxical fact, therefore, that, so far as these arbitrage transactions are concerned, the effect of the French and Italian operations would be to raise the sterling rate in New York, while the operations of the neutrals would be to depress it.

IV. The $100,000,000 Foreign Trade Financing Corporation

It is unnecessary to carry further this brief survey of European conditions. What it indicates is that the foreign trade and the capacity to produce, not merely of England but of other important countries, have distinctly improved during the past year. Though affording a brighter prospect for the future, this improvement does not, of course, alter the fact that our bankers and exporters are today burdened with the necessity of financing our trade balance, that they are now carrying some $2,852,000,000 of short-time export credits, and that this burden is growing heavier from month to month. That this method of export-financing is an unsound and temporary makeshift, which cannot be carried much farther, is generally recognized. Our most pressing problem today is to relieve the banks of this burden and provide a sound and permanent basis for a large and beneficial foreign trade.

I am in hearty accord with the decision of the government to withdraw from export financing. I see no valid grounds for the recent suggestions to revamp governmental war-time agencies to serve in times of peace. Such action could be of but temporary effect, and our situation demands a permanent trade financing mechanism. Moreover, the revival of governmental agencies would be in danger of prolonging the transition to more normal conditions. We must not forget that since the government ceased its credit advances to the Allies in June, 1919, and removed the various war-time restrictions upon foreign commerce, there has in fact been a very sensible trend toward a more normal trade balance. Down to last September the gap between exports and imports was being steadily cut down. That this process did not involve a positive decline in value of exports, we have seen to be due entirely to the continued rise of prices down to last May. The quantity figures show a distinct decline. If our export balance can not be financed in any other way than by extensions of short-time credit, whether these be made by the government or by banks, it is better that this decline of our exports should continue. There is little to be gained and much to be lost by indefinite continuance of a policy of paying for our exports out of our own pockets.

A method of trade financing which offers a satisfactory permanent basis for the continuance of a large and beneficial foreign trade is that provided by the Edge Act. And the most significant event relating to foreign trade since the armistice is the recent decision to establish a $100,000,000 foreign trade financing corporation under that act. There is not space to outline in detail the machinery provided by the Edge Act. In effect, the plan is to finance exports by the sale to American investors of the debentures (up to a maximum of $1,000,000,000) of the trade financing corporation, which debentures shall be secured by the rehypothecation of foreign securities delivered as collateral to the corporation by the foreign importers of our products. This plan has two advantages. It provides a means of supplanting short-time credits by long-time credits. In other words, it provides a method of accomplishing what we have seen, in the earlier portions of this paper, to be the only sound and effective basis for a permanently large and beneficial outflow of exports and the only means whereby the overturn of our trade balance can be postponed beyond a brief period —an outflow of American investments. In the second place, it removes the chief obstacle which in the past has largely prevented such an outflow—the hesitancy of the American investor, born of lack of familiarity with foreign conditions. Under this plan Americans will be asked to invest in the bonds of an American corporation, with which they are thoroughly acquainted and which has the active participation and support of our leading bankers throughout the country.

This mechanism is not unfamiliar or untried. It is the mechanism of the British, Scotch, Swiss, and other European investment trusts, which have been operated successfully since the third quarter of the last century. It is very similar to the method which has been employed in the United States in some lines of domestic trade. American electrical manufacturers, for example, have for many years sold equipment to street railway companies who could pay for it only with their corporate bonds maturing after a number of years. The manufacturers have maintained subsidiary companies which have taken street railway bonds, and deposited them with a trust company under a trust agreement to secure an issue of the subsidiaries' own notes, which the subsidiaries have then sold to corporations and individuals for permanent investment. For a different purpose, it has been employed, in one instance, in our foreign trade. On August 1, 1916, the American Foreign Securities Company, incorporated by a group of American bankers, made a three year loan of $100,000,000 to the French government, secured by a deposit as collateral by France of $120,000,000 of securities. These securities the company rehypothecated with a New York bank under a trust agreement to secure $94,500,000 of the Company's own three year

5 per cent notes, which notes the Company then offered to the public. That the operation was profitable is indicated by the fact that the company paid dividends throughout the three year period averaging more than 8 per cent upon its $10,000,000 of capital stock.[20]

In establishing foreign financing corporations under the Edge Act we should bear in mind two fundamental considerations. The first is that in the long run such corporations will render most effective service not in financing our trade with Europe but with other parts of the world. It is true that the European trade is today most in need of a sound financing mechanism. The present unsatisfactory state of our European trade, however, is but temporary, whereas the need for foreign investment to support foreign trade will be permanent and growing. And the avenues of trade expansion will not be European. On the future trend of American foreign trade the tendencies of prewar trade furnish unmistakable evidence. From 1900 to 1914 the proportion of our European trade to total trade steadily diminished, the decline being most marked in exports. Our trade with non-European countries expanded, the most marked increase being in trade with Canada and other North American countries. In the early years of the war exports to Europe expanded enormously, but the proportion fell off rapidly and in 1918, before the war was over, was only slightly larger than in 1914. Since the war, particularly in the past year, this process has gone farther.[21] The percentage of exports to Europe has diminished rapidly, reaching the lowest figure in our history, while exports to North America, South America, and Asia have greatly expanded, and reached new high marks. Similarly, the remarkable increase in our imports since the armistice has been chiefly from non-European countries.

The prewar tendencies in character of trade throw further light on the geographical distribution. The broad tendencies were:

1. The decline of exports of foodstuffs and the growth of imports.

2. The marked increase, absolutely and relatively, of exports of manufactures, and the more moderate decline in relative importance of imports of manufactures.

3. The increasing importance of raw materials, particularly in imports.[22]

20 For brief accounts of foreign investment trusts and of American analogies see the *Federal Reserve Bulletin,* November, 1920, pp. 1168-74; and "Foreign Financing Under the Edge Act," Guaranty Trust Company of New York, 1919.

21 Percentage of Exports to Europe, 1918—63 per cent
First 9 months 1920—54 per cent.

22 In other words, we were passing from the "young country" agricultural-extractive stage to the industrial stage. We were barely self-feeding. Imports of crude foodstuffs surpassed exports in each year from 1909 to 1914 and total food imports

The change from the agricultural-extractive to the industrial stage in our foreign trade is proceeding steadily and rapidly. It means three things. It means that an outflow of foreign investment is the logical expectation. That is shown by the experience of the other leading industrial nations. It means that in the long run this outflow will serve to finance the expansion of our trade primarily with the non-European world. The experience of other industrial nations indicates that this outflow will go mainly to the relatively young and undeveloped countries and will be closely allied with foreign trade expansion, in both exports and imports. And, finally, it indicates unmistakably that our capital, whether provided by corporations under the Edge Act or by any other process, will in the long run be used primarily to finance not exports of agricultural products but of manufactures. The present emphasis upon financing agricultural exports is but a temporary phase, due to the sudden drop of our price level, which has hit agricultural interests hardest.[23]

surpassed food exports in 1912 and 1914. Excluding cotton, exports of raw materials were declining in importance, and imports were growing rapidly, to feed our expanding industries. The war caused a slighter change in these proportions than appears at first glance. The chief change was the abnormal outflow of food products to Europe; but food exports at no stage of the war exceeded in volume the figures of 1899, and in the past year food exports have markedly declined.* Meantime the expansion of manufactures has continued. The percentage of manufactures to total exports was in 1900, 40 per cent; in 1914, 47 per cent; and in 1920 (nine months), 51 per cent.

* Percentage of food exports to total exports:

1914	17 per cent.
1919 (9 mos.)	36 " "
1920 (9 ")	25 " "

23 In conclusion, it must be repeated that the logical ultimate outcome of our altered international position as a result of the war must be an overturn of our trade balance. This does not imply a reduction of exports. Foreign investment will sustain a large export trade. It will not, however, prevent the overturn of the trade balance, though it is likely to postpone it for a time. The remarkable growth of imports, in quantity as well as value, down to last September, indicates that the overturn is likely to come quite as much by a process of imports growing up to exports as by a decline of exports. The growth of imports is, of course, desirable as well as logical. We cannot forget that foreign trade must be reciprocal, and rests ultimately upon the payment for goods with goods. A tariff-raising policy, therefore, would be at this time a mistake.

Though we shall doubtless succeed in maintaining a foreign trade substantially larger than in prewar years, there will be, of course, with the fall of prices, some decline in the value figures. That decline has already set in in the import trade, becoming marked last September. It was due primarily to the fall of prices in the foreign countries supplying the bulk of our imports (particularly in sugar, wool, coffee, hides, tea, silk, and other raw materials), coupled with the depression in this market induced by the fall of the domestic price level. That a corresponding drop has not occurred in exports is ascribable mainly to the fact that the harvest exports have been going forward.